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OFFICE OF THE COMPTROLLER
CITY OF ST. LOUIS

Internal Audit Section

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November 24, 2008

Shirley Emerson, Executive Director
Third Ward Neighborhood Council
3808 West Florissant
St. Louis, MO 63107

RE: Review of Ville Third Ward Neighborhoods Council, Community Development Block Grant (DBG), Contract #07-31-51, CFDA #14.218, (Project #2008-CDA33)

Dear Ms. Emerson:

Enclosed is a report of our fiscal monitoring review of Third Ward Neighborhoods Council, CDBG, for the period January 1, 2007 through December 31, 2007. The scope of a fiscal monitoring review is substantially less than an audit, and as such, we do not express an opinion on the financial operations of Third Ward Neighborhood Council. Fieldwork was completed on August 12, 2008.

This review was made under authorization contained in Section 2, Article XV of the Charter, City of St. Louis, as revised and has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* and through an agreement with the City of St. Louis, Community Development Administration (CDA) to provide fiscal monitoring to all federal grant sub-recipients.

If you have any questions, please contact Internal Audit Section at (314) 622-4723.

Sincerely,

Kenneth M. Stone

Dr. Kenneth M. Stone, CPA
Internal Audit Executive

Enclosure

cc: Jill Claybour, Acting Executive Director, CDA
Lorna Alexander, Special Assistant for Development, CDA

CITY OF ST. LOUIS

COMMUNITY DEVELOPMENT ADMINISTRATION (CDA)

THIRD WARD NEIGHBORHOOD COUNCIL
COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG)
CONTRACT #07-31-51
CFDA #14.218

FISCAL MONITORING REVIEW
JANUARY 1, 2007 THROUGH DECEMBER 31, 2007

PROJECT #2008-CDA33

DATE ISSUED: NOVEMBER 24, 2008

Prepared by:
The Internal Audit Section

OFFICE OF THE COMPTROLLER

HONORABLE DARLENE GREEN, COMPTROLLER

CITY OF ST. LOUIS
COMMUNITY DEVELOPMENT ADMINISTRATION (CDA)
THIRD WARD NEIGHBORHOOD COUNCIL, CDBG
FISCAL MONITORING REVIEW
JANUARY 1, 2007 THROUGH DECEMBER 31, 2007

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INTRODUCTION

Background

Contract Name: Third Ward Neighborhoods Council

Contract Number: 07-31-51

CFDA Number: 14.218

Contract Periods: January 1, 2007 through December 31, 2007

Contract Amounts: $155,000 increased to $319,684 (approved budget revisions)

The contract provided Community Development Block Grant (CDBG) funds to Third Ward Neighborhood Council (Agency) to provide clean, safe and affordable housing and refurbish building in the Third Ward. The Agency's goal is to transform its neighborhoods into self-reliant and economically viable communities; increase the number of homeowners in the area; reduce the number of decaying and abandoned properties; and put decaying properties back on the tax rolls.

Purpose

Our purpose was to determine Agency's compliance with federal, (including OMB Circular A-133), state and local CDBG requirements for the period January 1, 2007 through December 31, 2007 and make recommendations for improvements as necessary.

Scope and Methodology

Inquiries were made regarding the Agency's internal controls relating to the grants administered by Community Development Administration (CDA), tested evidence supporting the reports the Agency submitted to CDA and performed other procedures considered necessary. Our fieldwork was completed on August 12, 2008.

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INTRODUCTION

Exit Conference

An exit conference was conducted at Third Ward Neighborhood Council on August 11, 2008. Third Ward Neighborhood Council was represented by Shirley Emerson, executive director and Martha Wishom, office manager. The Internal Audit Section was represented by Ganet Desu and Olaide Hassan.

Management's Responses

Management did not respond to the observations and recommendations noted in the report.

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CONCLUSION AND SUMMARY OF OBSERVATIONS

Conclusion

The Agency did not fully comply with federal (including OMB Circular A-133), state and local CDA requirements.

Status of Prior Observations

The Agency's previous fiscal monitoring report dated December 7, 2006 contained three observations:

1. There appears to have a potential going concern issue **(Repeated, see Current Observation #1)**
2. Inadequate segregation of duties **(Resolved)**
3. Failure to properly inventory equipment **(Resolved)**

A-133 Status

According to a letter received from the Agency, it did not expend $500,000 or more in federal funds in its fiscal year ended December 31, 2007 and was not required to have an A-133 audit report.

Summary of Current Observations

We made recommendations for the following observations, which if implemented, could assist the Agency in fully complying with federal, OMB Circular A-133, state and local CDBG requirements.

1. Potential going concern issues (Repeated)
2. Outstanding payroll and earning taxes
3. Inadequate fidelity insurance
4. Opportunity to improve board of directors oversight responsibilities on finance
5. Inadequate segregation of duties
6. Failure to submit monthly financial report in a timely manner

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DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

1. Agency has Potential Going Concern Issues (Repeated)

Going concern refers to an entity's ability to function as a business entity. It is based on the assumption that it will continue operations for the foreseeable future. In addition, going concern measures the entity's ability to realize assets, discharge liabilities in the normal course of business, and generate sufficient resources to stay operational.

There is doubt about the agency's ability to continue as a going concern based on the analysis of its un-audited financial statements for the year ended December 31, 2007 and other factors as follows:

Working Capital

Working capital is a measure of an organization's ability to realize assets and satisfy liabilities in the normal course of business. It is the excess of current assets over current liabilities.

The Agency's balance sheet for the calendar year 2007 showed a negative working capital (an excess of current liabilities over current assets) of $78,552. It consisted of cash at bank of $9,481, a bank loan of $57,455 and payroll tax liabilities of $30,578.

The Agency balance sheet for the calendar year 2006 reported a negative working capital balance of $57,040.

Income Statement

The Agency income statement for the calendar year 2007 reported a net loss of $11,222.

Outstanding Payroll Taxes

As of the end of the final fieldwork date, the Agency owed $54,762 for the calendar years 2007 and 2008 federal, state and city payroll taxes (see Observation #2 below.)

Based on the facts stated above, it appears the Agency may not be able to continue operations for the foreseeable future in the normal course of the business.

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

1. **Continued...**

Recommendation

It is recommended the Agency:

- Seek additional funding sources to improve solvency.
- Pay off the outstanding payroll taxes and reduce other current liabilities.
- Improve budgetary controls to plan and monitor the expenses in order to comply with the requirements of its contract agreement with CDA.

Management's Response

According to CDA, the Agency did not respond to the observation.

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

2. Agency has Outstanding Payroll and Earning Taxes

The Internal Revenue Service (IRS) regulations, state statutes and City of St. Louis Ordinance requires the Agency to file payroll tax returns and remit payroll and earning taxes deducted from employees' payroll checks on a quarterly basis.

According to the IRS letter dated August 12, 2008, the Agency owed federal payroll taxes of $32,152.98 for the second, third and fourth quarters of 2007. In addition, the Agency owed the IRS $20,671.13 for 2008 payroll taxes. The total federal payroll taxes owed by the Agency are as follows:

Tax Quarter	Tax Year 2007	Tax Year 2008	Total
March 30	-	$12,416.41	$12,416.41
June 30	$ 9,893.10	11,646.92	21,540.02
September 30	10,278.29	1,956 78	12,235.07
December 31	14,008.36	-	14,008.36
Sub-total	$ 34,179.75	$26,020.11	$60,199.86
Less Paid/IRS Adjustments	($2,026.77)	($5,348.98)	($7,375.75)
Total Unpaid Federal Payroll Taxes	**$32,152.98**	**$20,671.13**	**$52,824.11**

In addition to the above federal payroll taxes, the Agency owed state payroll and city earnings taxes of $3,107.06 and $955.95 respectively first three quarters of the calendar year 2008 resulting in a total payroll tax liability as of August12, 2008:

Federal Payroll Taxes ------------------------	$52,824.11
State Payroll Taxes ---------------------------	3,107.06
City earnings Taxes --------------------------	955.95
Total Outstanding Payroll Taxes -----------	$56,887.12

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

2. Continued...

CDA fully reimbursed the Agency for the outstanding payroll and earnings taxes. The reimbursements received from CDA for the payroll taxes appeared to have been diverted by the Agency to pay for other expenses.

The Agency has reached an agreement with the IRS to pay $1,000 per month until the Agency has fully paid the total federal payroll taxes owed for 2007. No such agreement, however, exists for 2008 outstanding payroll taxes. The IRS has also placed a lien on the Agency's real estate at 3808 West Florissant for 2007 unpaid payroll taxes.

According to the IRS installment agreement, if the Agency does not meet the conditions of the agreement, the IRS will cancel the agreement and collect the entire outstanding amount by levying the Agency's income, bank account or other assets or by seizing its property. In addition, the Agency may lose its tax-exempt status. Unpaid amount may continue to attract interest and penalties thereby increasing agency unpaid payroll taxes worsening its financial position even more. CDA may suspend or terminate its contract with the Agency for the non-payment of the reimbursed payroll taxes.

Recommendation

It is recommended the Agency

- Implement effective budgetary controls or working capital management system and seek additional funding sources to achieve a more positive financial position.
- Remit all outstanding payroll taxes promptly to appropriate tax authorities.

Management's Response

According to CDA, the Agency did not respond to the observation.

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

3. Agency did not have Adequate Fidelity Insurance

Section 2.6 of the CDA Operating Agency's Fiscal Procedural Manual states, "Each CDBG subrecipient is required to have an *honesty blanket position* bond for its staff. This coverage is defined as "the loss sustained by any of the employees, acting alone or in collusion with others during the bond period." All persons employed or authorized to perform functions related to the execution of a CDBG-funded project or activity (e.g., paid officers or board members with check signing authority) shall be covered by, at a minimum, an h*onesty blanket position* bond coverage of $10,000. Chief executive and chief financial officers (CEO & CFO) are required to have a minimum coverage for $25,000.

The Agency did not maintain an *honesty blanket position* bonding for its employees as required by the contract. The Agency, however, had adequate bonding insurance for its CEO and CFO.

Failure to maintain adequate fidelity insurance increases the Agency's financial risk for the potential loss of federal funds resulting from theft or misappropriation of funds by employees.

Recommendation

It is recommended that the Agency comply with CDA's fidelity bonding requirements and maintain required fidelity insurance coverage for all of the Agency's employees.

Management's Response

According to CDA, the Agency did not respond to the observation.

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

4. Agency's Board of Directors did not Oversee Agency's Operations

Sound management practices require the board of directors to oversee the financial operations of the Agency.

Based on the review of the minutes of the board of directors' meetings held on March 29, August 1, and October 12, 2007 it was noted the board did not include the review of the finance report in its meeting agenda.

Board of director's failure to perform oversight responsibility may result in problems with the Agency operations that may go undetected.

Recommendation

It is recommended the board of directors review and discuss the Agency's financial activities at each of its regular meetings.

Management's Response

According to CDA, the Agency did not respond to the observation.

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

5. Agency did not Maintain Adequate Accounting Records

Sound accounting practices require the Agency to maintain adequate accounting records and prepare reports of its financial activities. These include, but not limited to maintaining a cash receipts and disbursement journals, check register, general ledger, payroll register, preparing monthly financial reports (income statement and balance sheet) and performing monthly reconciliation of the bank account.

The Agency maintained minimum accounting records such as checks and payroll register for personnel costs. The Agency had recently purchased QuickBooks accounting software to maintain accounting records and prepare financial reports. However, the Agency has not prepared any monthly financial reports (income statements and balance sheet) since the beginning of the year 2008. The last financial statement was for the period ended December 31, 2007 prepared by the external bookkeeper whose services had since been discontinued. Bank reconciliation statement has not been prepared since the beginning of the year 2008.

Failure to maintain adequate accounting records, and perform bank reconciliations may increase the risk of errors or fund misappropriation that might not be detected and corrected in a timely manner. The board of directors may not have a reliable financial information that will enable them perform their oversight responsibilities to the agency.

Recommendation

It is recommended that the Agency:

1. Train its personnel on the use of the automated accounting software (QuickBooks).

2. Maintain proper accounting records that include cash receipts and disbursement journals, check register, general ledger, and payroll register and prepare monthly and yearly financial statements of its operations.

3. Perform monthly bank reconciliations.

Management's Response

According to CDA, the Agency did not respond to the observation.

DETAILED OBSERVATIONS, RECOMMENDATIONS, AND MANGEMENT'S RESPONSES

6. Agency did not Submit Monthly Financial Report in a Timely Manner

The contract agreement with CDA requires the Agency to submit monthly financial reports to CDA no later than the 10th calendar day of the month following the report period end.

For document #55207, the Agency submitted five out of twelve monthly financial reports late on an average of 10 days. These reports for the months of April and June through September 2007 were submitted on May 15, July 20, August 24, September 19 and October 16, 2007 respectively.

Non-compliance with the CDA contract agreement requirements may cause a delay or suspension in the processing of reimbursement requests resulting in interruption in the Agency's services to its clients.

Recommendation

It is recommended the Agency comply with the CDA contract agreement requirements and submit its monthly financial reports by the 10th day of the month following the report period end for all current and future contracts.

Management's Response

According to CDA, the Agency did not respond to the observation.